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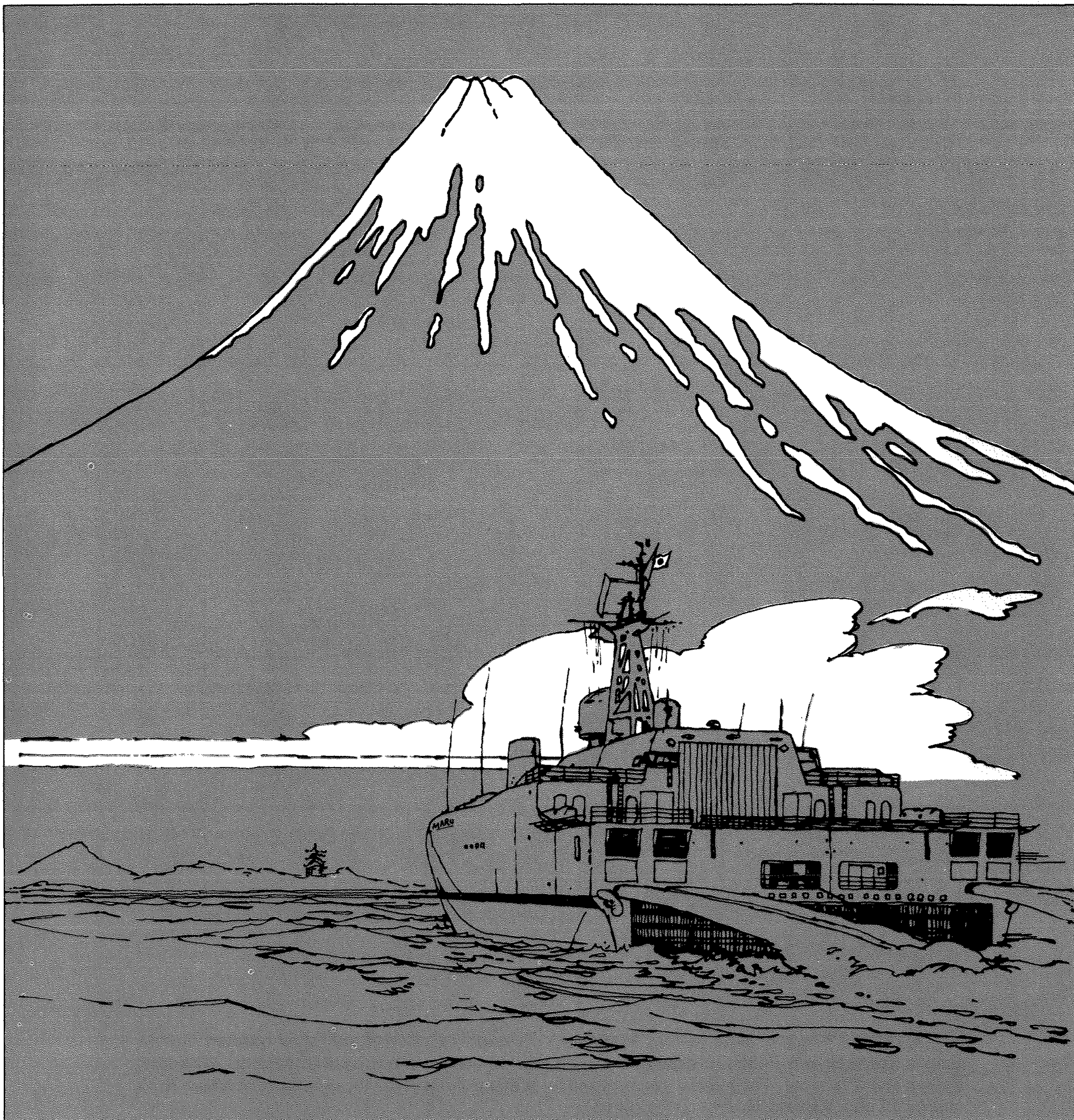

JAPAN: GROWTH AND PROSPECTS

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Japan: Growth and Prospects

The subject of Japan has always generated extreme opinions. In 1929, John E. Orchard said, "The causes that have retarded progress are so fundamental and so permanent that Japan cannot hope to become a manufacturing nation of major rank." But in 1970, Herman Kahn said, "The Japanese have, in effect, discovered or developed an ability to grow, economically, with a rapidity...that might well result, late in the twentieth century or early in the twenty-first, in Japan's possessing the largest gross national product in the world."

Serious students of Japan are aware of the fact that Japanese economic history provides many examples of both significant achievements and significant failings. This issue of the *Economic Review* provides evidence on both scores. The first article is an essay in the perennially rewarding field of growth analysis. The second article represents a first attempt to analyze a new financial phenomenon—the comparative record of American banks in Japan and of Japanese banks in the United States. The final article, in contrast, discusses an inefficient sector of the Japanese economy—agriculture, which penalizes Japanese urban consumers with some of the highest food prices in the world.

Martin Bronfenbrenner, on the basis of a lifetime of study in this area, summarizes his views of the Japanese growth process in the lead article. He notes that Japan has experienced not one but two "economic miracles" during the past century. The first miracle, which coincided roughly with the Meiji Era (1867–1912), propelled Japan in half a century to a world economic power of the second class—"itself a unique accomplishment for a non-European country with few significant natural resources, no significant Western population, and no history of Western colonization or dominance." The second miracle, which coincided roughly with the post-World War II period, "not only surpassed all extrapolations of prewar growth but also lifted Japan past Britain, France and Germany to the position of the world's third-ranking economic power."

Bronfenbrenner finds two schools of thought disagreeing over the causes of the two economic miracles. "The 'one-sword' school explains Japanese growth with a theory that cuts through a vital point of the economy—a point so vital that a push would set the whole economy pulsating. The 'literary' school contents itself with arraying large numbers of 'factors responsible' for whatever one is trying to explain." Bronfenbrenner personally leans toward the first school, his candidate for the role of "sword" being in Keynesian terms the high marginal efficiency of private domestic capital investment. But high marginal efficiency depends on public policies which diminish risk, such as those which provide major industries with guarantees against failure, financial stringency, or substantial layoffs of permanent workers.

Going further, Bronfenbrenner finds analogies to the three swords worn by the hero in every samurai movie. The power of the broad-sword—marginal efficiency augmented by risk diminution—has been supplemented by two additional aids to growth. One is the "short sword" of forced frugality, brought about by the "tax" of secular inflation. The other is the "dagger" of a highly productive, highly trained, and flexible labor force. These are in turn induced by two features of Japanese industrial relations: the "permanent" employment of rigorously and credentially selected employees and the weakness of craft unionism. The author also mentions several alternative explanations: a high private saving rate, low expenditures on national defense, cheap access to foreign technology, and yen undervaluation. But he emphasizes the importance of the three "swords," and gives the Japanese high marks for avoiding excesses (and incurring negative returns) when bringing those weapons into play.

In the second article on banking, Henry S. Terrell attempts to measure the impact of economic factors— such as growing trade flows and expanding local markets—which have affected the lending activities of American banks in Japan and of Japanese banks in the United States. In both cases, lending activity increased significantly between late 1972 and late 1978, although the growth pace fluctuated somewhat during that period. In the Japanese market, U.S.-bank branch claims on nonbanks (mostly loans) amounted to 2.3 percent of comparable loans and discounts at the large Japanese City Banks in November 1978. In the American market, the ratio of commercial-industrial lending of Japanese institutions to comparable U.S. weekly reporting banks reached 11.5 percent last November.

A model developed by Terrell did quite well in explaining the growth in lending activities of the two groups of banks. Changes in lending by U.S. banks in Japan were positively related to growth in local-bank lending, to growth in total Japanese trade, and to the degree of ease in the Japanese banking system—and negatively related to the degree of ease in the U.S. banking system. Meanwhile, growth in lending by Japanese banks in the U.S. market was positively related to the growth of the local U.S. market, and very strongly related to growth in total Japanese trade—and related to banking-market ease in the same way as were U.S. banks in Japan.

Yet certain key differences showed up in this analysis. The model indicates that growth in total Japanese trade strongly affects lending by U.S. offices of Japanese banks, reinforcing the widely-held view about the importance of those institutions in financing Japanese trade. In addition, Terrell shows that the impact of local-market growth on foreign-bank loan growth is much smaller for U.S. banks in Japan than for Japanese banks in the United States. This suggests that regulatory restraints on U.S. banks may have affected their ability to participate in the growth of the local Japanese market. "By contrast, Japanese banks in this country have been more free to expand their branch networks, operate subsidiary banks, and develop local sources of funding, and thus have been better able to benefit from growth in the local market."

In a third article, Michael Gorham considers one of the problem areas which mar Japan's otherwise strong economic performance—agriculture, which is a very high-cost supplier of food to the nation's consumers. Japanese consumers spend 39 percent of their budgets for food, compared with only 19 percent for U.S. consumers. These high food costs reflect the existence of a relatively inefficient agricultural sector, which is protected by a comprehensive system of tariffs and import quotas. "That policy reflects both the rurally-biased distribution of national political power and consumers' fears about the security of Japan's food supply."

Gorham examines an alternative and potentially cheaper food strategy—the removal of all barriers to grain and soybean imports, along with the creation of a one-year contingency stockpile of each of those commodities. He finds that the cost of stockpiling would have exceeded the net social cost of the current program in the mid-1970's, but he claims that the cost relationship probably would be reversed by the mid-1980's. By 1985, current policies could cost almost $8 billion, while the stockpile approach could run a little over $1 billion. But he cautions, "A switch to a stockpile approach could have a dramatic impact on the domestic farm economy, with falling prices, production, land values and incomes. Thus if such a policy switch took place, it would have to be implemented slowly."

Noting Japanese fears about secure food supplies, Gorham contends that the solution may center around the development of a major food-processing industry. "By becoming a supplier as well as a demander of foodstuffs, Japan could become an important part of the world food-supply system—one which could not be easily cut off in times of food shortages."